No. 847

In the Supreme Court of the United States

October Term, 1946

The United States, petitioner
v.
The Munsey Trust Company of Washington, D. C., receiver

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the Court of Claims (R. 17–28) is reported at 67 F. Supp. 976.

JURISDICTION

The judgment of the Court of Claims was entered on October 7, 1946 (R. 28). The petition for a writ of certiorari was filed on January 3, 1947, and was granted on March 3, 1947 (R. 29). The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925, as amended.

QUESTION PRESENTED

The United States owes a contractor about $12,500 under certain construction contracts; and the contractor owes the United States about $6,750 as the result of a separate, independent transaction. With respect to the construction contracts, a surety furnished bonds (as required of the contractor by law), guaranteeing payment of the contractor's obligations to materialmen and laborers; and the surety has satisfied unpaid material and labor claims, in the amount of about $13,000, under such contracts.

The question presented is whether the surety's payment of those claims deprives the Government of its otherwise unquestioned right to set off the $6,750 debt owed it by the contractor.

STATUTES INVOLVED

The pertinent portions of the statutes involved are set forth in the Appendix, pp. 41–48.

STATEMENT

The facts as found by the Court of Claims may be briefly summarized as follows:

The Federal Contracting Corporation, a New York corporation (sometimes referred to herein as "the contractor"), between May 10 and July 26, 1940, entered into six contracts with the United States, through the Public Buildings Administration, for the painting and repair of vari-

ous buildings belonging to the Government (R. 13).[1] The Aetna Casualty and Surety Company (sometimes referred to herein as "the surety") furnished the two bonds required by law of the contractor under each of the contracts, one guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and laborers (R. 14).[2] In connection with each of these bonds the contractor entered into an "indemnity agreement" with the surety whereby it agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all monies that might be due and payable to it on its failure to pay bills incurred in the work (R. 14).

The contractor failed to make payments, totaling

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[1] These contracts were as follows (R. 13):

"Post Office, Denver, Colorado, Contract WA-2-pb-531, May 10, 1940.

"Post Office and Court House, Tulsa, Oklahoma, Contract WA-2-pb-629, July 6, 1940.

"Post Office, Whitewater, Wisconsin, Contract WA-2-pb-597, July 2, 1940.

"Customs House, Portland, Maine, Contract WA-2-pb-609, July 2, 1940.

"Post Office, Skowhegan, Maine, Contract WA-2-pb-702, July 16, 1940.

"Post Office, Gallup, New Mexico, Contract WA-2-pb-806, July 26, 1940."

[2] These bonds are required by the Miller Act, 49 Stat. 793, 40 U. S. C. 270a, *et seq.*; Appendix, pp. 41-45. The Miller Act superseded the Heard Act, 28 Stat. 278, as amended, 33 Stat. 811, 40 U. S. C. 270, Appendix, pp. 45-47.

$13,065.93, to persons who had furnished labor and material for use in the performance of five of the contracts.[3] The surety made these payments in accordance with its obligation under the payment bonds, and in connection therewith each of those persons assigned to the surety his rights against the contractor (R. 15). Upon completion of the contracts by the contractor, and after allowance of credit for payments made, there remained due and owing from the United States to the contractor a total of $12,445.03 on account of the six contracts (R. 16).

On October 18, 1940, the contractor submitted a bid in the sum of $20,743.00 to the United States for the painting of the United States Post Office at St. Louis, Missouri (R. 15). The bid was accepted, however, the contractor failed to enter into a formal contract therefor and failed to give the bond required in connection therewith (R. 15). The work was thereafter relet to a third party and performed at a cost of $7,146.50 over and above the contractor's bid (R. 15). After the application of the bid deposit of $415, there remained an indebtedness of $6,731.50 due to the United States from the contractor on account of its St. Louis bid (R. 15).

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[3] The contractor paid all the claims of the materialmen and laborers on the Denver contract. The surety was required to pay $8,640.10 on the Tulsa contract, $648.00 on the Whitewater contract, $2,528.00 on the Portland contract, $35.00 on the Skowhegan contract, and $1,214.83 on the Gallup contract (R. 15).

On June 4, 1941, one Klein, a stockholder of the contractor, instituted an action in the District Court of the United States for the District of Columbia, seeking the appointment of a special receiver [4] to receive from the United States the amounts due under the above-mentioned six contracts, and the distribution of those amounts to the laborers and materialmen or, in the alternative, to the surety, who, by counterclaim and cross-claim, joined in the same prayers (R. 15). Subsequently the Munsey Trust Company, respondent herein, a District of Columbia banking corporation, was appointed receiver and was directed by the order of its appointment to demand and receive from the United States all the proceeds of the six contracts, and to hold the proceeds of all collections for the reimbursement of the surety for expenditures made by it to those who furnished labor and material under such contracts (R. 15–16). The action was dismissed as against the Secretary of the Treasury, the Treasurer of the United States and the Commissioner of Public Buildings, who had been named as defendants (R. 16).

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[4] In accordance with the established procedure in the courts of the District of Columbia, such receivership is for the purpose of taking possession of a fund or property and preventing its loss or dissipation. It does not necessarily involve insolvency, *Houston* v. *Ormes*, 252 U. S. 469, and no claim that the contractor is bankrupt, insolvent, or otherwise unable to meet his obligations, has been made by any of the parties.

Pursuant to the order of its appointment, respondent made demand upon the United States for the proceeds of the balances due under the several contracts (R. 16.) The General Accounting Office paid to respondent \$5,713.53, which represented the balance due under the contracts, after deducting \$6,731.50 which was applied in liquidation of the contractor's indebtedness to the United States by reason of its default under the St. Louis Post Office bid (R. 16).[5] Respondent and the surety each protested this set-off, but the Comptroller General affirmed the action taken in the matter (R. 16). Respondent reported these facts to the District Court, and was authorized to pay over to the surety \$5,213.53 from the funds in its hands, retaining \$500 as expenses, and to institute suit in the Court of Claims for the recovery of such further amounts as might be due under the contracts (R. 16–17).

In the Court of Claims, respondent, who had received \$5,713.53, claimed that the surety had an equitable right to the fund in question (R. 13), and that respondent was entitled to a further balance of \$3,568.23 for the benefit of the surety, on the ground that the surety was entitled to a total of \$9,281.76, representing the total of the payments to laborers and materialmen made by

[5] Finding No. 8 of the court below (R. 16) shows how the \$6,731.50, the amount applied to the St. Louis indebtedness, was allocated among the several contracts.

it under each contract, to the extent that each contract balance was sufficient to permit such payment (R. 17).[6]

The Court of Claims held that when the surety paid the claims of the laborers and materialmen, it was subrogated to all the equities in their favor, which although "not a lien in the strict and proper sense, brings kindred consequences along with it" (R. 25); that "neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances in the Government's hands" (R. 27); and, therefore, that "the right of the surety and of plaintiff, as receiver, which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset" (R. 28). Accordingly, it held that respondent was entitled to recover $3,568.23, and entered judgment in that amount (R. 28).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that the rights of the surety upon

[6] Finding No. 10 of the court below (R. 17) shows the balances due under each contract, payments by the surety to the furnishers of labor and material under each contract, and the amounts claimed by respondent under each contract.

paying the claims of the materialmen and laborers, although "not a lien in the strict and proper sense, brings kindred consequences along with it."

2. In holding that upon paying the claims of contractor's materialmen and laborers, the rights of the surety to the fund in the hands of the Government were superior to the right of the Government to a set-off.

3. In holding that the United States, in respect of the retained fund, was merely a stakeholder.

4. In holding that, despite the general right of the Government to make offsets, its claim to the retained fund was no better than that of a general creditor of the contractor.

5. In holding that, despite the provisions of Rev. Stat. 236, the Government's claim to the retained fund was no better than that of a general creditor of the contractor.

6. In holding that the United States could not set off its claim against the contractor against the balance due to him because of the equities of the surety.

7. In entering judgment for the respondent.

SUMMARY OF ARGUMENT

I

A. The United States was both a creditor and debtor of the contractor. Even in the absence of statute, the Government had the right, which belongs to every creditor, to set off mutual

debts. Congress has, since the earliest days, required that this right of set-off be asserted affirmatively. Even in bankruptcy or receivership, where the existence of a right of set-off becomes particularly important, the right of offset has been universally recognized. Although it has the effect of paying one creditor more than another, this results in no preference since only the balance after the deduction of the set-off can properly be considered an asset of the insolvent.

In the present case, the record does not show whether the contractor is insolvent, bankrupt or otherwise unable to discharge all its obligations; respondent is a special receiver appointed in accordance with the practice of the local courts to receive and distribute a particular fund. If the contractor is solvent, denial to the United States of the right of set-off will result only in circuity of action and needless inconvenience and expense.

B. Respondent's suggestion that the debts are not mutual is based on the theory that only the contractor is indebted to the United States, and that both the contractor and surety, or the surety alone, are its creditors. But, as between the United States and the contractor, it is plain that the debts are mutual. This would seem conclusive here since respondent is a special receiver and its rights to the fund are those of the contractor, not of the surety; the latter is not entitled to any portion of the fund unless

the district court subsequently orders a distribution to it. Even if the surety had acquired some rights in the retained fund, the debts here involved would still be mutual, since the surety's obligation is merely security for that of the principal; and since, by the very nature of subrogation, the surety upon payment of the creditor is merely substituted for the creditor with respect to the latter's rights.

II

The Government's right of offset is not affected by the surety's subrogation since that doctrine does not operate to place the surety in any better position than the person whose claim has been satisfied. Accordingly, the surety here was not subrogated to any rights which could defeat the Government's offset.

A. The contractor's rights to the retained fund were not superior to those of the United States. Subrogation thereto does not place the surety in any better position.

B. Nor does subrogation to the rights of materialmen and laborers give the surety such superior rights. The finding of the court below that the materialmen and laborers and, derivatively, the surety, had rights which brought consequences "kindred to an equitable lien" was, in effect, a holding that they had the equivalent of an equitable lien on the fund. That such is the holding is clear, since the cases from which the court below quoted exten-

tively adopted the equitable lien theory, and apparently the distinction between an equitable lien and the rights here found to exist by the court below was evolved merely to avoid literal inconsistency with its other decisions.

The conflict among the various lower federal courts as to whether the materialmen and laborers and, derivatively, the surety, have an equitable lien on the retained fund, arises from the recognition that the United States has an equitable obligation to see that the laborers and suppliers are paid. Such obligations are not legally binding and, at most, are moral obligations. The purpose of the Heard and Miller Acts was merely to substitute the legal obligation of a surety for the Government's moral obligation.

Furthermore, there is nothing in the Miller or Heard Acts, or in the contract or the bond which can be construed as creating any lien, equitable or otherwise, on the retained fund in favor of the materialmen and laborers and the surety, and, as the court below has recognized, the fund is not retained to pay the materialmen and laborers. The surety admittedly took the risk that the Government might pay the retained balances to the contractor who might dissipate ~~the~~ money in speculation or otherwise and fail to pay the materialmen and laborers. And the surety clearly also assumed the risk that the retained fund might be used to discharge other liabilities of the contrac-

tor, such as his liability on the St. Louis bid. So far as the surety is concerned, that is the effect of what happened here, although it was accomplished by set-off rather than by delivery and redelivery of the money.

C. Since the United States had only a moral obligation to see that the laborers and materialmen were paid, payment by the surety did not subrogate it to the rights of the United States. Even if the surety had discharged a binding obligation of the Government, it nevertheless would not be subrogated to the rights of the United States, since all of the Government's claims against the contractor had not been paid. Respondent has been paid the balance remaining after full satisfaction of the Government's claims.

D. Because of this right of offset, *Prairie State Bank* v. *United States*, 164 U. S. 227, and the other cases relied on by the court below based thereon, are inapposite. In those cases there was no question involved as to the Government's right of set-off, since the United States was merely a stakeholder of a fund and asserted no claim to the fund. Moreover, in the *Prairie State Bank* case, the surety had completed performance under its performance bond. But here the surety is not subrogated to the rights of the United States, since it paid, under its payment bond, merely the claims of materialmen and laborers who had no legally binding claim against the United States, and since

all claims of the United States against the contractor had not been discharged.

Maryland Casualty Co. v. *United States*, 100 C. Cls. 513, is the only litigated case dealing with the precise question here involved. There the Court rejected the subrogation theory and allowed recovery on the assumed intention of the parties when the contract was executed. But the decision based on that assumption seems clearly wrong, since the surety should have been held to be chargeable at the time the contract was executed and the bond furnished with knowledge of the Government's right to set-off, long established by judicial decisions and administrative practice.

ARGUMENT

The claim of the surety to the retained balances under the contracts arises solely from the payments which it made pursuant to its bond securing the payment of materialmen and laborers. The contractor completed the work under the six contracts, and no question is involved as to the rights of the surety to the fund retained under the performance bonds. During the course of the performance of these contracts, the United States made progress payments to the contractor, but withheld, as provided by the contracts, certain percentage balances which became due thereunder. The contractor having become indebted to the United States by reason of its default under the St. Louis bid, the General Accounting Office when

settling the claims of the contractor, applied sufficient of the retained balances to cancel the St. Louis Post Office bid claim of the United States against the contractor.

The court below held that the relationships of debtor and creditor of the United States to the contractor should be treated separately; that, as a debtor of the contractor, the United States was merely a stakeholder of the retained fund, and that, as a creditor, the rights of the United States were not superior to those of any other general creditor. The court further held that the surety, and the respondent as special receiver, had an equitable right in the retained fund which, although not amounting to an equitable lien, brought "kindred consequences" with it, and was, therefore, superior to the rights of general creditors, including the United States.

We believe, however, that by virtue of the fact that the United States occupied the relationships of both debtor and creditor to the contractor, it had a right, under both the general law and under Rev. Stat. 236 (Appendix, *infra*, p. 41), to set off its claim against the contractor, and that this right of set-off is not subordinate to any rights or equities which the surety may have acquired by virtue of having discharged the contractor's liability to his materialmen and laborers in accordance with the terms of the payment bonds.

I

THE UNITED STATES WAS BOTH A CREDITOR AND A DEBTOR OF THE CONTRACTOR; IT HAD THE RIGHT, THEREFORE, TO SET OFF THE DEBT DUE FROM THE CONTRACTOR AGAINST THE BALANCE DUE HIM

A. Had the contractor not defaulted in making payments to its materialmen and laborers, and had the surety not become liable under its payment bonds, there could be no question about the duty and authority of the General Accounting Office to set off the contractor's indebtedness to the United States on account of its default on the St. Louis bid against the balance due from the United States under the completed contracts. For it is well settled that, even in the absence of a statute, the United States has the right to effect accounting set-offs and adjustments in connection with claims presented to it for payment; it may do so in "the exercise of the common right, which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." *Gratiot* v. *United States*, 15 Pet. 336, 370; *McKnight* v. *United States*, 98 U. S. 179, 186.

Congress has, from the earliest days of our government, charged the Treasury Department, and since 1921 the General Accounting Office, with the duty of administratively settling the Government's accounts.[7] Act of September 2,

[7] By the Act of March 3, 1875, 18 Stat. 481, as amended by the Act of March 3, 1933, Title II, sec. 13, 47 Stat. 1516, 31

1789, c. 12, sec. 3, 1 Stat. 65, 66; Act of March 3, 1817, c. 45, sec. 2, 3 Stat. 366; Rev. Stat. 236, as amended by Section 305 of the Budget and Accounting Act of June 10, 1921, 42 Stat. 20, 24.[8] And in settling the Government's accounts, the set-off of mutual claims has long been recognized as the uniform practice of the accounting officers, and it is well established that such officers have not only the power, but it is their duty, to do so, since, as stated in *Barry* v. *United States*, 229 U. S. 47, 53, "It would be folly to require the Government to pay under the one contract what it must eventually recover for a breach of the other." See also *Gratiot* v. *United States*, *supra*; *McKnight* v. *United States*, 13 C. Cls. 292, affirmed, 98 U. S. 179; *Bonnafon* v. *United States*, 14 C. Cls. 484, 489; *Taggert* v. *United States*, 17 C. Cls. 322, 327; *Howes & Co.* v. *United States*, 24 C. Cls. 170, 185–186; *Labadie* v. *United States*, 33 C. Cls. 476, 480; *Schooner Henry* v. *United*

U. S. C. 227, the Comptroller General is directed to withhold payment of a judgment creditor as an offset against the indebtedness of that creditor to the United States. This statute is similar to R. S. 236 in that it "provides a way of payment and satisfaction if the creditor shall, at the time of the presentation of his judgment, be a debtor of the United States * * *." *United States* v. *Jones*, 119 U. S. 477, 480.

[8] By the Act of June 10, 1921, 42 Stat. 20, 23 *et seq.*, the General Accounting Office, headed by the Comptroller General, was created as an independent agency, and Rev. Stat. 236 was amended to require all settlements and adjustments to be made in that office instead of in the Treasury Department.

States, 35 C. Cls. 393, 395; *American Sanitary Rug Co. v. United States*, 84 C. Cls. 417; *John P. Squire Co. v. United States*, 90 C. Cls. 276, 285, certiorari denied, 309 U. S. 689.

The setting off of mutual debts is not a right peculiar to the sovereign, but rather is one common to all creditors. Unlike the present case, where there is no allegation, claim, or finding that the contractor is bankrupt, insolvent, or otherwise unable to meet his obligations, the cases dealing with the right of offset arise most frequently when a debtor is unable to satisfy completely all his creditors and is in bankruptcy or general receivership. And even in those circumstances the right to set off debts due has been universally conceded. As this Court pointed out in *Scott* v. *Armstrong*, 146 U. S. 499, 511:

> * * * the bankruptcy act of 13 Eliz. c. 7, contained no provision in any way directing a set-off or the striking of a balance, and by its second section, commissioners in bankruptcy were to seize and appraise the lands, goods, money and chattels of the bankrupt, to sell the lands and chattels, "or otherwise to order the same for true satisfaction and payment of the said creditors, that is to say, to every of the said creditors a portion, rate and rate alike, according to the quantity of his or their debts." 4 Statutes of the Realm, Part I, 539. Yet, in the earliest reported decisions upon set-off, it was allowed under

this statute. *Anonymous*, 1 Mod. 215; *Curson* v. *African Co.*, 1 Vern. 121; *Chapman* v. *Derby*, 2 Vern. 117.

See also *Cumberland Glass Co.* v. *De Witt*, 237 U. S. 447; *Lowden* v. *N. W. National Bank*, 298 U. S. 160; *Fidelity & Deposit Co.* v. *Duke*, 293 Fed. 661 (C. C. A. 9); cf. *Blount* v. *Windley*, 95 U. S. 173, 177. This "precept, framed on the example of ancient laws across the seas (4 Anne, c. 17, § 11; 5 Geo. II, c. 30, § 28)," has been carried over into the United States. Cf. *Lowden* v. *N. W. National Bank*, *supra*, at 163. And in the United States, the Bankruptcy Acts have from the beginning expressly provided for such offsets.[9]

While the operation of this privilege of set-off may have the effect of paying one creditor more than another, no preference is said to be involved therein, since "it is clear that it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent." *Scott* v. *Armstrong*, *supra*, at 510; *N. Y. County Bank* v. *Massey*, 192 U. S. 138, 147; *Fidelity & Deposit Co.* v. *Duke*, *supra*, at 665.

[9] The present set-off provision (Section 68 (a)) of the Bankruptcy Act of 1898 (30 Stat. 565, 11 U. S. C. 108 (a)), was taken almost literally from Sec. 20 of the Act of March 2, 1867, 14 Stat. 517, 526. As presently worded, it provides: "(a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

Accordingly, even if the contractor were insolvent or bankrupt, the United States would have the right to set off mutual debts, as it did in the present case, irrespective of its priorities under Rev. Stat. 3466 or Section 64 of the Bankruptcy Act (11 U. S. C. 104).[10]

In the present case, however, the record does not show whether the contractor is able to meet his obligations. No insolvency, actual or formal, or bankruptcy has been alleged, claimed, or found. The receivership here involved is a special receivership of the type which is commonly created in the District of Columbia in accordance with the procedure and practice of its courts to receive and distribute a particular fund.[11] *Houston* v. *Ormes*, 252 U. S. 469, 473; *Morgenthau* v. *Fidelity*

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[10] For this reason, cases such as *In re Van Winkle*, 49 F. Supp. 711 (W. D. Ky.), *New York Casualty Company* v. *Zwerner*, 58 F. Supp. 473 (N. D. Ill.), and *In re Heintzelman Construction Company*, 34 F. Supp. 109 (W. D. N. Y.) are not here relevant. These cases deal with competing claims of the United States and the surety against a bankrupt, but there is no question raised or involved as to the right of set-off under Section 68 (a).

[11] Since the purpose of the receivership is to obtain payment of a fund from a Government official, where the duty to pay is purely ministerial and compellable by mandamus (*Houston* v. *Ormes*, 252 U. S. 469), it seems anomalous that the district court should appoint a receiver and at the same time dismiss the suit against the Government officials. Although the United States Attorney consented to that order of the court (R. 5-6), his consent was, of course, limited solely to the dismissal of the suit against the Government officials.

& Deposit Co., 94 F. 2d 632 (App. D. C.); *Jones* v. *Rutherford*, 26 App. D. C. 114; *Roberts* v. *Consaul*, 24 App. D. C. 551, 562; *Sanborn* v. *Maxwell*, 18 App. D. C. 245. Under that procedure, there is no requirement that the person for whose fund the receivership is created be factually or even formally insolvent or bankrupt. If the contractor here is solvent and able to discharge his liability to the United States as well as to the surety for the payments the latter made to the unpaid materialmen and laborers,[12] the claims of both the United States and the surety will be satisfied. In such circumstances, the sole function served by refusing to permit the United States to offset its mutual debts would be to remit it to its rights against the contractor, and since the money here involved is insufficient to satisfy the entire claim of the surety against the contractor, the surety would still have to pursue the contractor for the remainder. Accordingly, there would probably be three suits, where one—a suit against the contractor by the surety—would be sufficient. Such "circuity of action inconvenience, expense, consumption of the courts' time, and injustice" (cf.

[12] As has been stated, the record affords no clue as to the solvency of the contractor. It is to be doubted, as a practical matter, however, that the interested parties would have pursued the cumbersome receivership remedy if the contractor were in fact solvent and able to meet all his obligations.

Cherry Cotton Mills, Inc. v. *United States,* 327 U. S. 536, 539; *Barry* v. *United States,* 229 U. S. 47, 53) are results which the setting off of mutual debts prevents.

B. Respondent has suggested that the debts here involved are not mutual (Br. in Opp. 7–8), and that for this reason the right of set-off is not available. This contention is apparently based on the theory that only the contractor was indebted to the United States on the St. Louis bid, while both the contractor and the surety, or the surety alone, had claims to the retained fund against the United States. But if there were here involved only the respective rights of the Government and the contractor, there clearly could be no question of the mutuality of the debts, since the sole parties to the mutual debts would be the United States and the contractor, and since both debts would be liquidated. And it is difficult to see why this mutuality should disappear merely because of the claim asserted on behalf of the surety. Furthermore, to the extent that there must be an agreement between the parties that one claim shall stand against the other, such understanding has apparently always been uniformly assumed where the United States has been one of the parties to the mutual debts. See cases cited, *supra,* pp. 16–17.

This would appear to be the present situation, since the respondent is a special receiver for the fund here involved and as such must rely on the rights of the contractor thereto. The sole rights of the surety to the fund are dependent on the order of the district court appointing the special receiver. Initially that court ordered the receiver to hold the fund subject to its order (R. 5–6). "Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended," the district court ordered that the receiver pay the sums already paid over by the Government to the surety, and to institute the present proceeding (R. 11–12). It may be assumed, although it does not appear that the district court has as yet so ordered, that any monies recovered in the present proceeding will be distributed to the surety.

Even if the surety by subrogation acquired some rights in the retained fund, the debts here involved would still be mutual. *Fidelity & Deposit Co.* v. *Duke*, 293 Fed. 661 (C. C. A. 9); *Peirce* v. *Bent*, 69 Me. 381; *Downer* v. *Dana*, 17 Vt. 518; *Ex parte Hanson*, 12 Ves. 346, 18 Ves. 232. This follows from the very nature of subrogation, whereby the subrogee is merely substituted to the rights of the creditor, subject to all infirmities and defenses available against the

claim to which he is subrogated. See *infra*, pp. 24–25. And it is generally settled that upon being sued by the creditor the surety may, in the absence of hardship upon his principal, set off the claims available to his principal since in such a case the obligation of the surety which makes the debt joint is nothing more than a security for the separate debt of the principal. *Temple St. Cable Ry.* v. *Hellman*, 103 Cal. 634; *Wagner* v. *Stocking*, 22 Ohio St. 297, 301; *Gunnis, Barrett & Co.* v. *Weigley*, 114 Pa. 191; *Mahurin* v. *Pearson* 8 N. H. 539; *Newell* v. *Salmons*, 22 Barb. (N. Y.) 647; 3 Story, *Equity Jurisprudence* (14th ed.), sec. 1874; Levine, *Principal's Warranty and Offset Claims against the Creditor as Defenses to the Surety*, 30 Mich. L. Rev. 197.

II

THE GOVERNMENT'S RIGHT OF SET-OFF IS NOT AFFECTED BY THE SURETY'S RIGHT OF SUBROGATION

The court below states at one point in its opinion that the surety by paying the contractor's unpaid materialmen and laborers became subrogated to the rights of the contractor, of the materialmen and laborers, and of the United States to the retained balance in the hands of the Government (R. 18). However, the principal basis for the holding below seems to be that the surety was subrogated to the right of the materialmen and laborers to the fund, which right, the court said "even if not a lien in the strict and proper sense,

brings kindred consequences along with it" (R. 25).[13]

It is a basic principle of subrogation that "the party for whose benefit the doctrine of subrogation is exercised can acquire no greater rights than those of the party for whom he is substituted. The doctrine of subrogation was never intended to be used as an instrument to circumvent the principles of equity and by circuitous action to permit the assignee to be placed in a more advantageous position than the assignor from whom his rights devolved." *Globe Indemnity Co.* v. *United States,* 84 C. Cls. 587, 595, certiorari denied, 302 U. S. 707.[14] See also *Phoenix Insurance Co.* v.

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[13] In the Agreement of Indemnity entered into between the surety and the contractor, the contractor agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all moneys that might be due and payable to it upon its failure to pay bills incurred in the work, *supra,* p. 3. Neither the respondent nor the court below has suggested that this assignment vested rights to the retained fund in the surety superior to those of the United States. Nor could such a suggestion be properly advanced, since there is no question that this assignment, as such, is void as against the United States because of Rev. Stat. 3477, as amended, 31 U. S. C. Sec. 203. *Martin* v. *National Surety Co.*, 300 U. S. 588; *Prairie State Bank* v. *United States*, 164 U. S. 227; *Goodman* v. *Niblack*, 102 U. S. 556, 560.

[14] The Court of Claims in *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513, distinguished as inapplicable the *Globe Indemnity* case on the ground that in that case, the contractor's claim had been "literally nonexistent as a result of the forfeiture under the statute, so of course neither

Erie Transportation Co., 117 U. S. 312, 321; *City of Philadelphia* v. *National Surety Corporation*, 140 F. 2d 805, 808 (C. C. A. 3); *Reconstruction Finance Corp.* v. *Teter*, 117 F. 2d 716, 727 (C. C. A. 7); *Alexander* v. *Young*, 65 F. 2d 752, 757 (C. C. A. 10); *Swarts* v. *Siegel*, 117 Fed. 13, 15, 16 (C. C. A. 8); *Southern Surety Co.* v. *United States*, 75 C. Cls. 47; Sheldon, *Subrogation* (2d Ed.), §§ 1, 6. This is so because "the doctrine of subrogation is derived from the civil law, and 'it is said to be a legal fiction, by force of which an obligation extinguished by a payment made by a third person is treated as still subsisting for the benefit of this third person, so that by means of it one creditor is substituted to the rights, remedies, and securities of another * * *.'" *Aetna Life Insurance Co.* v. *Middleport*, 124 U. S. 534, 548. Thus, subrogation is merely a substitution of one person in the place of another whose claim has been satisfied, and hence the surety's rights to the retained fund in the present case depend on what rights the persons to whom he is

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the surety nor anyone else could enforce it" (100 C. Cls. at 519), whereas in the present situation, the surety had acquired rights which the principal would not have been entitled to because in his hands they would be subject to a set-off or other valid defense not involving forfeiture of the claim (100 C. Cls. at 520). Since the surety cannot obtain by subrogation any better or greater rights than the person to whose rights he is subrogated, this distinction is obviously unsound.

subrogated had against the retained fund at the time of payment.[15]

Since, as is shown below, the surety became subrogated by virtue of his payment of the unpaid claims of the contractor's materialmen and laborers to no rights which were superior to the Government's right of offset, we submit that subrogation to such rights does not enable the surety to defeat the Government's right to retain the fund through offset.

A. We have already shown *supra*, pp. 15–20, that, had the contractor not defaulted and had the surety had not been called upon to pay the unpaid materialmen and laborers, the United States would have had an undoubted right to apply the retained fund against the contractor's liability on the St. Louis bid. Hence, subrogation of the surety to the rights of the contractor does not enable him to defeat this right of the United States to offset.

B. Nor does subrogation to the rights of the materialmen and laborers give the surety any rights which are superior to the Government's right of offset. The finding of the court below that the materialmen and laborers and, deriva-

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[15] Because the rights the surety acquires by subrogation are neither greater nor better than those which the person for whom he is substituted had at the time of the payment which effected the subrogation, it has been held that "the surety is not subrogated to a right which originally existed in favor of the creditor, but which the latter released or discharged before payment by the surety." *Alexander* v. *Young*, *supra*, at 757.

tively, the surety, had rights which brought consequences "kindred to an equitable lien" is, in effect, a holding that an equitable lien did arise. This is clear from the cases from which the court below quoted extensively and upon which it relied in support of this ground of its decision, since those cases adopted the equitable lien theory. See, e. g., *Moran* v. *Guardian Casualty Co.*, 76 F. 2d 438 (App. D. C.); *Farmers' Bank* v. *Hayes*, 58 F. 2d 34, 37 (C. C. A. 6) (R. 21, 22). The distinction drawn by the court below between an equitable lien and rights which bring consequences kindred thereto is, we submit, wholly without substance. Apparently, it was evolved by that court in order to avoid literal inconsistency between its decision in this case and its decisions in other cases wherein it held that in similar circumstances no equitable lien arose. See *Seaboard Surety Co.* v. *United States*, 67 F. Supp. 969, certiorari denied March 3, 1947, No. 846, this Term, decided the same day as the present case; *Dewey Schmoll* v. *United States*, 105 C. Cls. 415, 455, certiorari denied October 14, 1946, No. 244, this Term; *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513.

As the court below recognized in *Seaboard Surety Co.* v. *United States*, *supra*, at 971, the decisions of the various lower federal courts are in conflict on the question of whether a retained fund such as is here involved is chargeable with

an equitable lien in favor of unpaid laborers and materialmen and a surety who pays their claims. *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.*, 271 Fed. 144 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235, 238 (C. C. A. 8), ~~with~~ *Third National Bank* v. *Detroit Fidelity & Surety Co.*, 65 F. 2d 548 (C. C. A. 5); *Kane* v. *First National Bank*, 56 F. 2d 534 (C. C. A. 5); *Fidelity & Deposit Co.* v. *Union State Bank*, 21 F. 2d 102 (D. Minn.). This conflict has been recognized, but not resolved, by this Court. *Martin* v. *National Surety Co.*, 300 U. S. 588, 593. See also cases cited in *Seaboard Surety Co.* v. *United States*, *supra*, at 972.

This contrariety of judicial opinion rests in part upon too literal a reading of this Court's opinion in *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404. See *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.*, 271 Fed. 144, 149 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235, 238 (C. C. A. 8). In the *Henningsen* case, this Court held that the surety which had paid the contractor's unpaid materialmen and laborers in accordance with the bond was entitled to the retained balances as against the bank which had loaned money to the contractor, saying "[the surety] paid the laborers and material-men and thus released the contractor from his obligations to them, and to the same extent released the Government from all

equitable obligations to see that the laborers and supply men were paid" (208 U. S. at 410).

While it is true that the United States has a moral obligation to see that the laborers and materialmen are paid, that obligation does not, as the court below has held in other cases, give rise in the materialmen and laborers to an equitable lien to the retained fund. *Seaboard Surety Co.* v. *United States, supra; Dewey Schmoll* v. *United States, supra; Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513. It is settled that the materialmen and laborers do not have any lien on the work being performed (*Hill* v. *American Surety Co.*, 200 U. S. 197, 203; *Equitable Surety Co.* v. *McMillan*, 234 U. S. 448, 455), nor do they have any legally binding claim against the United States, even in the absence of a bond securing the payment of their claims. *Kellogg* v. *United States*, 7 Wall. 361; *H. Herfurth, Jr., Inc.* v. *United States*, 89 C. Cls. 122. At most, the obligation of the United States is a moral one, and even that moral obligation is not that the United States itself should pay the materialmen or laborers, but only to see that they are paid. Cf. *Henningsen* v. *United States Fidelity & Guaranty Co., supra; California Bank* v. *United States Fidelity & Guaranty Co.*, 129 F. 2d 751, 754 (C. C. A. 9).

The purpose underlying both the Heard and the Miller Acts was to discharge this moral obligation by furnishing to the materialmen and labor-

ers the obligation of a surety as a substitute for the statutory lien to which they would generally be entitled if the work were not on a public contract. *Guaranty Co.* v. *Pressed Brick Co.*, 191 U. S. 416, 425; *Hill* v. *American Surety Co.*, 200 U. S. 197, 203; *Mankin* v. *Ludowici-Celadon Co.*, 215 U. S. 533; *Equitable Surety Co.* v. *McMillan*, 234 U. S. 448, 455. And on this obligation, the surety guarantees nothing to the principal—the Government—although the latter permits an action upon the bond for the benefit of the materialmen and laborers. *Guaranty Co.* v. *Pressed Brick Co., supra; Equitable Surety Co.* v. *McMillan, supra,* at 456. Thus, as stated in H. Rep. No. 1263 and Sen. Rep. No. 1238, 74th Cong., 1st Sess., which accompanied the bill that later became the Miller Act, the sole purpose of the payment bond is "to afford greater protection to subcontractors, laborers, and materialmen," and to assure that their claims against the contractors will be paid. Section 1 (a) (2) of the Miller Act requires a payment bond with surety "for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person," and Section 2 provides that the unpaid materialmen and laborers shall have the right to sue on the payment bond for the unpaid amount or balance thereof in the name of the United States for the use of the person suing. It is clear that both the Heard

and Miller Acts were intended only to discharge the moral obligation of the United States to the materialmen and laborers by creating in them a right of action against the surety. *MacEvoy Co.* v. *United States*, 322 U. S. 102; *Texas Cement Co.* v. *McCord*, 233 U. S. 157; *Hill* v. *American Surety Co.*, 200 U. S. 197; *Guaranty Co.* v. *Pressed Brick Co.*, *supra*. Indeed, under the Heard Act, where only a single bond was required covering both performance of the work and payment of materialmen and laborers, the unpaid claims of the materialmen and laborers were subordinate to the claims of the United States, which were to be paid in full before any distribution could be made to the materialmen and laborers. *Brogan* v. *National Surety Co.*, 246 U. S. 257, 261; *Illinois Surety Co.* v. *Peeler*, 240 U. S. 214, 218. The effect of this subordination was mitigated by the requirement in the Miller Act that two separate bonds be furnished, a performance bond to protect the Government and a payment bond to protect the materialmen and laborers.[16]

[16] The Heard Act provided for a single bond for the protection both of the Government and the suppliers of labor and materials, and to prevent the penalty of the bond from being depleted before the Government could enforce its claims the Government had sole right to sue for six months after completion of the work and final settlement. Other claimants could sue only thereafter and had to join in a single action. Serious inconveniences and delays resulted and often the claimants, in sore need of immediate funds, were compelled to settle meritorious claims for less than the full

Furthermore, there is nothing in the Miller and Heard Acts, or in the contract or the bond, which can be construed as creating any lien, equitable or otherwise, on the retained fund in favor of the laborers and materialmen, and the surety. As pointed out by the court below in *Dewey Schmoll* v. *United States*, *supra*, at 455:

> * * * If the contractor fails or refuses to pay its laborers and materialmen, the Government is not liable therefor, and it is not obligated or authorized to use the retained amounts to pay them. Therefore, the surety, upon payment of them, acquires no equitable lien on the retained amount, since it was not retained to secure performance of the obligation the surety discharges.

And in *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513, 520, the court below said:

> The bond involved in the instant case was not a "performance" bond, but a "payment" bond. It is not clear that moneys were withheld from the contractor in order

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amount. Hearings on H. R. 2068, et al., *Bonds of Contractors on Public Works*, House Committee on the Judiciary, 74th Cong., 1st sess.; 79 Cong. Rec. 11702, 13382; H. Rep. No. 1263 and S. Rep. No. 1238 (74th Cong., 1st sess.). The Miller Act was designed to meet these difficulties by requiring that the contractor execute two bonds, a performance bond to protect the Government and a payment bond to protect the creditors. Creditors could sue on the latter without waiting for the Government and even without waiting for completion of the project; they were given the right to sue ninety days after their labor was completely performed or materials fully supplied, and each creditor could sue separately. (See *MacEvoy Co.* v. *United States*, 322 U. S. 102, 105–106, fn. 4.)

to give the Government additional security that materialmen and laborers would be paid. So far as appears, the balance of the contract price would have been paid to Columbia, if it had not been credited on Columbia's taxes, without any investigation as to whether Columbia had paid its materialmen and laborers. If so, that would indicate that the Government, which would have no more than a moral obligation to see these creditors paid, relies entirely on the payment bond with regard to such debts of the contractor. The analogy of subrogation to additional security may, therefore, not be properly applicable to the type of bond here involved.

Since, as further pointed out in the *Maryland Casualty* case, the surety took the risk that the Government pay the contractor the retained balance which the contractor might spend "in speculation or in riotous living and fail to pay his materialmen and laborers" (100 C. Cls. at 521), the surety's risk surely also included the contractor's using the retained balance to discharge his liability to the Government on the St. Louis bid. The procedure adopted by the General Accounting Office in the present case had precisely the same result as far as the surety is concerned. The contractor was paid the amount due and owing it under the contracts by credit against his liability on the St. Louis bid, and this result was accomplished by one action instead of two.

Accordingly, since the materialmen and laborers had no equitable lien on the retained fund, the surety, upon being subrogated to their rights, likewise had no equitable lien thereon. *City of Philadelphia* v. *National Surety Corp.*, 140 F. 2d 805, 808 (C. C. A. 3); *Adamson* v. *Paonessa,* 180 Cal. 157; *Robinson Mfg. Co.* v. *Blaylock*, 192 N. C. 407.

C. Contrary to the statement of the court below (R. 18), the surety was not subrogated to any rights of the United States. The obligation discharged—the payment of claims of laborers and materialmen—was not that of the United States, for, as we have already shown, *supra,* pp. 28–31, the United States was not legally obligated to pay the laborers and materialmen, and at most had a moral obligation to see that they were paid. Secondly, even if the claims paid were binding obligations of the United States, the surety would nevertheless not be subrogated to the United States, since all its claims against the contractor had not been discharged, and it is a "familiar rule of the law of subrogation under which a surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied." *United States* v. *National Surety Company,* 254 U. S. 73, 76; *American Surety Co.* v. *Sampsell,* 327 U. S. 269; *American Surety Co.* v. *Electric Co.,* 296 U. S. 133; *Jenkins* v. *National Surety Co.,* 277 U. S. 258, 266–267;

Peoples v. *Peoples Bros.*, 254 Fed. 489, 491, 492 (E. D. Pa.); *United States Fidelity & Guaranty Co.* v. *Union Bank & Trust Co.*, 228 Fed. 448, 455 (C. C. A. 6). In the present case, the United States paid to respondent the balance remaining after its claim had been fully satisfied.

D. Because of the Government's right of offset, cases such as *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404; *Moran* v. *Guardian Casualty Co.*, 76 F. 2d 438 (App. D. C.); *Farmers' Bank* v. *Hayes*, 58 F. 2d 34 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235 (C. C. A. 8); *Morgenthau* v. *Fidelity & Deposit Co.*, 94 F. 2d 632 (App. D. C.) (R. 21–24, 25), from which the court below quoted at length and upon which it relied to support its holding in the present case, are inapposite. All of these cases depend ultimately on *Prairie State Bank* v. *United States*, 164 U. S. 227, also relied upon by the court below.[17] In the latter

[17] The court below also cited *United States Fidelity & Guaranty Co.* v. *United States*, 92 C. Cls. 144 (R. 18), and *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513 (R. 19, 24). In the *Fidelity & Guaranty* case the surety elected to complete a contract after the contractor's default in accordance with the terms of its performance bond and entered into a supplemental agreement with the United States, which agreement provided that any amounts retained from payments made to the original contractor should be paid to the surety upon completion of the work. In accordance with the terms of the supplemental contract, the Court of Claims held that the surety was entitled to the retained amounts. The supplemental agreement, and the fact that

case, the question presented was whether a surety on a performance bond covering a building contract, who, upon the default of the contractor, had taken over and completed the work, acquired a better right to the sums of money retained by the Government to assure performance of the contract than a bank to which the contractor had assigned the retained sums. This Court there held that the assignment made to the bank had no effect because of Rev. Stat. 3477 forbidding the assignment of claims against the United States; and that, in any event, the surety was entitled to the fund because its rights, dating from the execution of the original contract, had been acquired prior to those of the bank.

Those cases are clearly inapplicable here. First, in the *Prairie State Bank* case, as in the other cases, the Government was merely a stakeholder, and asserted no adverse claim to the fund. In the case at bar there existed an undischarged indebtedness of the contractor to the United States, and the Government asserted a claim to the fund which was adverse to all other claims against it. Secondly, in the *Prairie State Bank* case, all of the claims of the United States against the contractor had been satisfied, and the surety who was said to be subrogated to the rights of the United States

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the surety discharged his obligation under the performance bond, distinguish that case from the present case. The *Maryland Casualty* case is discussed at some length, *infra*, pp. 37-40.

had, under the performance bond, discharged the contractor's obligation to the United States. In the present case, however, all of the claims of the United States had not been discharged, and the surety paid merely the claims of the materialmen and laborers under the payment bond. Furthermore, neither that case nor any of the other cases relied upon by the court below involved any question of the right of the Government to apply a set-off.

Maryland Casualty Co. v. *United States*, 100 C. Cls. 513, is the only litigated case where the precise question here involved has been decided.[18] In that case the Court of Claims rejected as invalid the subrogation theory, which it adopted in the present case, as a ground on which to allow recovery by the surety; instead, it based its opinion on the assumed intention of the parties at the time the contract was entered into and the bonds were furnished. It held the surety did not assume under the payment bond the risk that part of the contract price would be credited against taxes or other debts, unrelated to the contract,

[18] Prior to the *Maryland Casualty* decision, the Treasury Department, until 1921, and the General Accounting Office thereafter, had consistently set off claims such as are here involved. The first case in which any question was raised as to the propriety of this practice was *Standard Surety & Casualty Co. of New York* v. *United States*, C. Cls. No. 45410, which was voluntarily dismissed by plaintiff after the Government's brief was filed.

which the contractor owed to the Government,"[19] and hence that when the surety entered into its contract of suretyship, it did so with the understanding that if it should discharge the contractor's obligation it would be entitled to the contractor's rights against the United States. But the decision in that case seems to us to be clearly wrong, since the surety should have been held to be chargeable with knowledge, actual or

[19] In its opinion, the Court of Claims pointed to what appears to be the anomalous situation, if the Government's right of set-off is sustained, of the surety being put in a position of "paying" the principal's debts to the Government if it elects to complete the contract upon the contractor's default, whereas it saves itself from such a consequence if it does not elect to complete. But in electing to complete, the surety is no more paying the contractor's debts to the United States on independent transactions than any other creditor of an insolvent or bankrupt pays those debts of his debtor which are similarly set off. However, the existence of such a set-off is only one of the factors which the surety should consider in determining whether it would be to his financial advantage to complete the project. Among the other factors to be considered is the financial condition of the contractor, since the surety in seeking reimbursement is not restricted solely to the specific funds arising from the particular contract, but may look also to the contractor's assets generally. Hence, even though the contractor is indebted to the United States, the surety may still elect to complete, because it may feel it can do the job more cheaply than others, even taking into consideration the possibility of the Government's using the contract moneys to satisfy other claims it has against the contractor. In any case, the anomaly posed by the Court of Claims would arise only where the contractor had defaulted under the performance bond and has no bearing when, as in the present case and the *Maryland Casualty* case, the surety is called upon to pay unpaid materialmen and laborers in accordance with the payment bond.

otherwise, of the Government's right of set-off, long established by judicial decisions and by statute, and by the continuous and well-recognized practice followed by the Treasury Department prior to 1921, and thereafter by the General Accounting Office. See cases cited *supra*, pp. 16-17. Indeed, the statute authorizing set-offs may well be regarded as having become, by operation of law, an inherent part of the surety's bond under the Miller Act. *Von Hoffman* v. *City of Quincy*, 4 Wall. 535, 550; cf. *Hill* v. *American Surety Co.*, held (105 C. Cls., 415, 455):

In *Dewey Schmoll* v. *United States*, *supra*, where the contractor was formally insolvent, the surety similarly urged that its undertaking on the payment bond did not include the risk that claims of the United States would be entitled to priority under Rev. Stat. 3466. The Court of Claims there held:

> When the surety on the payment bond entered into its contract of suretyship it did so with the understanding that if it discharged its principal's obligation it would be entitled to its principal's rights against the United States, but, when it did so, it had knowledge, constructive or otherwise, of this section 3466 which gave the United States priority; and the agreement of the United States that the surety should become subrogated to its principal's rights against it must be understood to have been made subject to the limitation that the Gov-

ernment should neverthele have the priority given it by this statute.

No good reason appears why the surety here should not likewise be charged with the knowledge of the Government's right of set off. See *Von Hoffman* v. *City of Quincy, supra; Hill* v. *American Surety Co., supra.*[20]

CONCLUSION

For the reasons stated, the judgment below is erroneous and should be reversed.

Respectfully submitted.

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[20] As a commercial surety, it knew the settled practice of the General Accounting Office in connection with these matters and the basis on which accounts are regularly settled. It fixed its premiums accordingly. Moreover, as a professional surety, in competition with other professional sureties, it necessarily takes risks and expects to sustain some losses. There is no room here for the application of any doctrine that doubts shall be resolved in favor of the surety. As a matter of fact, the expense of the surety bond was ultimately borne by the United States since that unquestionably was an expense taken into account by the contractor when he computed his bid.

APPENDIX

1. Rev. Stat. 236, as amended by Section 305 of the Budget and Accounting Act of June 10, 1921, 42 Stat. 20, 24, 31 U. S. C. 71 provides:

> All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office.

2. Rev. Stat. 3477, 31 U. S. C. 203, provides in part as follows:

> All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. * * *

3. The Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.* provides:

> SEC. 1. (a) Before any contract exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United

States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract, Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

SEC. 2. (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: *Provided, however*, That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by

registered mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

SEC. 3. The Comptroller General is authorized and directed to furnish, to any person making application therefor who submits an affidavit that he supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and the contract for which it was given, which copy shall be prima facie evidence of the contents, execution, and delivery of the original, and, in case final settlement of such contract has been made, a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. Applicants shall pay for such certified copies and certified statements such fees as the Comptroller General fixes to cover the cost of preparation thereof.

SEC. 4. The term "person" and the masculine pronoun as used throughout this Act shall include all persons whether individuals, associations, copartnerships, or corporations.

SEC. 5. This act shall take effect upon the expiration of sixty days after the date of its enactment, but shall not apply to any contract awarded pursuant to any invitation for bids issued on or before the date it takes effect, or to any persons or bonds in respect of any such contract. The Act entitled "An Act for the protection of persons furnishing materials and labor for the construction of public works", approved August 13, 1894, as amended (U. S. C., title 40, sec. 270), is repealed, except that such Act shall remain in force with respect to contracts for which invitations for bids have been issued on or before the date this Act takes effect, and to persons or bonds in respect of such contracts.

4. The Heard Act, 28 Stat. 278, as amended by 33 Stat. 811, 40 U. S. C. 270, which was superseded by the Miller Act, provided:

> * * * any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation

who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and materials shall, upon application therefor, and furnishing affidavit to the Department under the direction of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and

execution: *Provided,* That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later: *And provided further,* That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *Provided further,* That in all suits instituted under the provisions of this Act such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors; and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.

5. Rev. Stat. 3466, 31 U. S. C. 191, provides:

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

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